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***To the Citizens of the Commonwealth of Massachusetts,  
Governor Mitt Romney, Lieutenant Governor Kerry Healey,  
and Honorable Members of the General Court***

I am pleased to transmit the Commonwealth's fiscal 2005 (FY05) Comprehensive Annual Financial Report (CAFR) prepared in accordance with Generally Accepted Accounting Principles (GAAP) in the United States of America. The report is the primary means of reporting the Commonwealth's financial activities. The objective of this report is to provide a clearer picture of our government as a single, unified entity.

This document presents the Commonwealth's financial information on three bases of accounting, each serving a different purpose. The back of the report includes as "required supplementary information" budgetary basis statements, which are prepared in accordance with the Commonwealth's budgetary basis of accounting or statutory basis. More detailed information on the statutory basis of accounting and the results of operating on that basis from FY05 are found in the Statutory Basis Financial Report (SBFR) separately issued this past October. The SBFR report documents compliance with the legislatively adopted budget at a fund level. Further documentation is found within reports from the Commonwealth's accounting system, the Massachusetts Management Accounting and Reporting System (MMARS). Each state maintains different rules for budgetary reporting and therefore the SBFR should not be used for comparison across states.

The fund perspective statements on pages 40 to 44 present the governmental operations on a modified accrual basis of accounting. The fund perspective is designed to measure inter-period equity, the extent to which current resources (available within the next year) fully fund all current services provided by the government. Long-term liabilities are excluded with the implicit assumption that future tax revenues will fund these liabilities as they come due. This fund perspective provides results similar to the statutory basis financial statements published in October.

In addition to the fund perspective, this CAFR presents a government-wide perspective. This perspective combines all governmental and business activities in a statement of net assets and a statement of activities, presenting all functions on a full accrual basis of accounting.

All fixed assets, including road and bridge infrastructure, are added to the statements as are all long-term liabilities. Funds that are shown as fiduciary under the fund perspective are not portrayed in the government-wide statements, as the assets do not belong to the Commonwealth.

In the government-wide statements, the balance sheet has been organized into a “net assets format.” This format classifies all assets and liabilities as short and long-term and then subtracts liabilities from assets to arrive at net assets.

The Commonwealth’s government-wide revenues, expenses and activities are included in the statement of activities. The expenses of the Commonwealth, organized by activity, are netted against fees, fines, grant revenues and assessments generated to fund each activity in an attempt to derive the net cost to the taxpayer of each activity. The format allows the reader of the financial statements to discern the net cost of a particular function of government funded by taxation and other general revenues by a review of this statement.

This CAFR is presented in three sections: **Introductory, Financial and Statistical**. This **Introductory Section** contains an overview of current initiatives and summary financial data. The **Financial Section** contains a Management’s Discussion and Analysis (MD&A) section, and the Commonwealth’s Basic Financial Statements. GAAP requires that management provide a narrative overview and analysis to accompany the basic financial statements in the form of MD&A. This letter of transmittal is designed to complement MD&A where the financial analysis is now presented. The Commonwealth’s MD&A can be found immediately following the independent auditors’ report. The **Statistical Section** contains selected financial and demographic information. It also contains background information on the Commonwealth.

## PROFILE OF THE COMMONWEALTH

The Commonwealth of Massachusetts was the sixth of the original 13 colonies to ratify the United States Constitution, joining the United States on February 6, 1788. Boston, the capital of the Commonwealth since its founding, dates from 1630. The Commonwealth has an area of 8,257 square miles. Geographically, the Commonwealth includes 351 cities and towns. The largest city is the capital, Boston. Employment is largely in the education, health services, wholesale and retail trade, warehousing and public utilities sectors. The Massachusetts Constitution was ratified in 1780 while the Revolutionary War was still in progress, nine years before the United States Constitution was adopted. It is the oldest written Constitution now in use in the world. It specified three branches of Government: Executive, Legislative, and Judicial. “The Great and General Court,” elected every two years, is made up of a Senate of forty members and a House of Representatives of one hundred and sixty members. The Massachusetts Senate is the second oldest democratic deliberative body in the world.

The table below reconciles the fund balances on three basis of accounting, the statutory basis presented in separately issued financial statement this past October, and the fund basis and entity wide basis statements included in this report.

### **Governmental Funds - Statutory to GAAP - Fund Perspective and to Governmental Net Assets**

(Amounts in millions)

#### **Governmental Funds - Statutory Basis, June 30, 2005:**

Budgeted fund balance.....	\$	2,487.2
Non Budgeted Special Revenue fund balance.....		1,686.1
Capital Projects fund balance.....		<u>(160.9)</u>

**Governmental fund balance - Statutory Basis, June 30, 2005..... \$ 4,012.4**

Plus: Expendable Trust and similar fund statutory balances that are

considered Governmental Funds for GAAP reporting purposes.....	337.1
Owner Controlled Insurance Program Net Assets.....	<u>132.2</u>

**Net adjustment to governmental fund balance..... 469.3**

**Adjusted statutory governmental fund balance..... 4,481.7**

Accruals, net of allowances and deferrals for increases /(decreases):

Taxes.....	1,267.9
Medicaid.....	(209.2)
Master Settlement Agreement receivables.....	127.2
Compensated absences.....	(5.2)
Contract Assistance due to Component Units.....	<u>(277.8)</u>

Other accruals:

Liabilities related to universal health.....	(163.3)
Claims, judgements and other risks.....	(57.9)
Workers' compensation and group insurance.....	(102.3)
Other accruals, net.....	<u>(12.6)</u>

**Net change to governmental fund balances due to accruals..... 566.9**

**Governmental fund balance (fund perspective)..... 5,048.6**

Plus: Fixed assets including infrastructure.....	29,595.3
Less: Accumulated depreciation.....	(7,375.8)
Plus: Deferred revenue, net of other eliminations.....	573.5
Less: School construction grants payable.....	(8,397.3)
Central Artery / Tunnel Project assets to be transferred to MTA .....	(11,640.7)
Bonds payable, current and long term.....	(17,856.8)
Other current and long term liabilities.....	<u>(1,490.9)</u>

**Net changes to entity wide statements..... (16,592.7)**

**Total governmental net assets (entity wide perspective)..... \$ (11,544.1)**

### **REPORTING ENTITY**

The financial statements incorporate activity from over 150 departments. These departments include the various agencies, boards, and commissions, the 25 institutions of higher education, the judicial and legislative branches of government, and constitutional offices. The departments record their daily financial operations in the state accounting system, MMARS, operated by the Office of the Comptroller.

In addition, the financial statements include 29 independent public authorities and the State Employees' and Teachers' Retirement Systems. These entities defined as component units meet the criteria for inclusion in the reporting entity in accordance with GAAP, which are

further described in Note 1 to the financial statements. A new component unit, the Massachusetts School Building Authority was established for FY05 in order to fund school construction in the Commonwealth. The results of its operations are blended into the Commonwealth's operations.

## **ECONOMIC CONDITION**

By most measures, the Commonwealth has outperformed the national economy in recent years. This year was no exception and the trend might continue in the future. Over the last ten years, the Commonwealth's unemployment rate has ranged from .3% to 1.3% below the national unemployment rate. This is largely due to the Commonwealth's large employment base from the education and health and human services sectors, which stabilize the economy. Per capita net income also over the past decade has been at least 20% ahead of the national average. Further economic data is found in the statistical section to this report.

## **INDEPENDENT AUDIT**

The Commonwealth's independent auditors, Deloitte & Touche, LLP, together with subcontractors and assistance by the Office of the State Auditor (OSA) have performed an independent audit of the Commonwealth for the fiscal year ended June 30, 2005. OSA also plays a significant role in the audit of the Schedule of Federal Financial Assistance of the Commonwealth, as prescribed in the Federal Office of Management and Budget's Circular A-133. The independent auditor's report is presented in the Financial Section.

The OSA is statutorily mandated to perform audits of the accounts, programs, activities and functions of all departments, offices, commissions, institutions and activities of the Commonwealth. OSA provides its knowledge, expertise, experience and resources as a participant in the single audit of the Commonwealth, which encompasses all of the Commonwealth's financial operations. A more complete discussion of this work can be found in the State Auditor's semi-annual report available on their web site: <http://www.mass.gov/sao>.

The Office of the Comptroller prepares these financial statements and assumes responsibility for the completeness and reliability of the information presented in this report. To provide a reasonable basis for making these representations, the Office of the Comptroller, working in conjunction with the State Auditor, has established a comprehensive internal control framework that is designed to protect the Commonwealth's assets from loss, theft, or misuse and to compile sufficient reliable information for the preparation of the Commonwealth's financial statements in conformity with GAAP. Because the cost of internal controls should not outweigh their benefits, the Commonwealth's comprehensive framework of internal controls has been designed to provide reasonable, rather than absolute assurance that the financial statements will be free from material misstatement.

## **FINANCIAL SYSTEM**

In September of 2002, the Commonwealth undertook a two-year project to upgrade its statewide accounting system to a web-based software with minimal customization.

The issuance of this report marks the completion of the first full year of implementation. The system is meeting the major success factors outlined at the initiation of the project, including:

- The system went “live” on schedule at the opening of FY05.
- The project was “under budget,” returning \$2.4 million of the project contingency fund.
- The system was available to users 96% of its scheduled “up time” – 8:00AM to 6:00PM Monday through Friday. The system is usually available for additional time in the morning outside these planned hours.
- 100% of critical payments were issued on schedule. The system issued a payment file to the Treasurer each day with the exception of two. On these two days, the problem was corrected within 24 hours.
- 1.3 million payments, totaling \$31.5 Billion, have been issued by the system.
- The financial statements contained herein were prepared using the system and issued on schedule with an unqualified opinion included on pages 15 through 17. No material weaknesses were identified with the system.

Some challenges remain:

- The nightly cycle still occasionally requires manual intervention to complete on schedule.
- On-line response time occasionally slows down preventing users from working effectively in the system.
- Users still request additional training and assistance in some of the more complicated areas of the application.

While these areas result in frustration, they are not serious enough to impede the Commonwealth’s functions. The Chief Information Officer of the Commonwealth, the vendor, CGI-AMS and I have an aggressive action plan monitored on a weekly basis to address these remaining issues.

I again would like to express my thanks to the many dedicated employees within the Office of the State Comptroller and across the government who have worked to upgrade the Commonwealth’s accounting system, MMARS. This has been a significant effort but will provide enduring benefits to the Commonwealth

Respectfully submitted,

Martin J. Benison  
Comptroller of the Commonwealth